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August 15, 2013

Docket Control
Arizona Corporation Commission
1200 W. Washington
Phoenix, AZ 85007

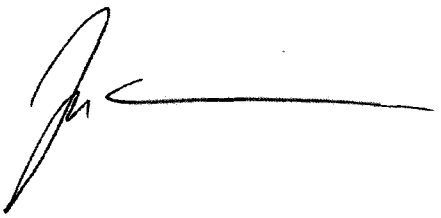
Re: *Electric Cooperatives' Comments on Retail Electric Competition (Docket No. E-00000W-13-0135)*

Dear Sir/Madam:

The following comments on retail electric competition/restructuring ("ER") are provided by the Arizona Electric Power Cooperative, Inc. ("AEPCO"), Southwest Transmission Cooperative, Inc. ("SWTC"), Duncan Valley Electric Cooperative, Inc. ("Duncan"), Graham County Electric Cooperative, Inc. ("Graham"), Mohave Electric Cooperative, Inc. ("Mohave"), Navopache Electric Cooperative, Inc. ("Navopache"), Trico Electric Cooperative, Inc. ("Trico") and Sulphur Springs Valley Electric Cooperative, Inc. ("Sulphur") (collectively, "the Cooperatives"). The Cooperatives submit these reply comments to other parties' responses to the questions presented in Staff's Notice of Inquiry dated May 23, 2013.

Sincerely,

GRAND CANYON STATE ELECTRIC
COOPERATIVE ASSOCIATION



By _____

John V. Wallace

Original and thirteen (13) copies of
Electric Cooperatives' Comments
filed this 15th day of August, 2013
with:

DOCKET CONTROL
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

ELECTRIC COOPERATIVE REPLY COMMENTS ON RETAIL ELECTRIC MARKET RESTRUCTURING (DOCKET NO. E-00000W-13-0135)

The following reply comments on retail electric market restructuring ("ER") are provided by the Arizona Electric Power Cooperative, Inc. ("AEPCO"), Southwest Transmission Cooperative, Inc. ("SWTC"), Duncan Valley Electric Cooperative, Inc. ("Duncan"), Graham County Electric Cooperative, Inc. ("Graham"), Mohave Electric Cooperative, Inc. ("Mohave"), Navopache Electric Cooperative, Inc. ("Navopache"), Trico Electric Cooperative, Inc. ("Trico") and Sulphur Springs Valley Electric Cooperative, Inc. ("Sulphur") (collectively, "the Cooperatives"). The Cooperatives submit these reply comments to the other parties' responses to the questions presented in Staff's Notice of Inquiry dated May 23, 2013.[1]

We discuss the effects of ER on Cooperatives in response to the general comments filed by the other parties on July 15. We also provide comments on the other parties' responses to the questions posed in Staff's Notice of Inquiry that were filed on July 15, 2013. Some 60 different persons and entities filed hundreds of pages of comments opposing, supporting or stating, in certain instances, bafflement as to their precise positions on ER. Given this, the Cooperatives will not attempt to respond to every issue raised nor argument asserted. Our failure to address any particular item, assertion or issue is not to be construed as acquiescence to or agreement with it.

[1] Rebuttal Comments on legal issues are attached as Exhibit A.

Individual cooperatives may supplement these comments. The Cooperatives, individually and collectively, also reserve the right to refine and revise these initial observations as new information becomes available.

Introduction

Accountability to Our Cooperative Members

Most of the ER proponents state that utilities should fully divest generation assets to a separate entity. Placing to one side the fact that Arizona's courts have ruled such forced divestiture unconstitutional, non-profit, member-owned electric cooperatives have promised that we will provide affordable, safe and reliable electricity to members at the least cost and that includes generation capability. We are accountable to our members and the ACC. For over 50 years under the current system, we have planned, built and reliably operated generation and transmission facilities to maintain and assure affordable, safe and reliable electric service.

How will this change under ER? We will have little, if any, control over planning, building, maintaining, pricing and retiring generation plants and transmission because:

1. The Nation's wholesale markets, which are overseen by the Federal Energy Regulatory Commission ("FERC"), will control the supply and price of electricity.
2. An ISO/RTO will control the bulk power system and is also subject to FERC jurisdiction.
3. Generators will no longer be accountable to customers or the ACC. In all likelihood, generation will only be constructed when the price for its output is expected to be high enough. However, despite high generation price signals, necessary new generation still has not been built in certain states that have ER such as Texas, Maryland and New Jersey.

4. Finally, without firm purchased power arrangements supporting the sale of wholesale plant output at retail, financing a new plant will either not be possible or will carry a high premium.

ER will bring a fundamental shift in the cooperative business model from local ownership and control to undefined "market" and federal control. Generation will no longer be planned and constructed to meet rural Arizona customers' needs. Generation will only be constructed when the prices are high enough to warrant construction. While this may be a good deal for some providers, the real questions are will rural Arizonans' needs be met and, if so, will they be able to afford the price?

Under ER, the utilities, Cooperatives and Commission will surrender to the "market" and the FERC decisions which are currently made locally. As prices rise and reliability declines, it will be difficult – if not impossible – for us to explain to our constituents, members and customers why we are no longer in control of generation and its price and reliability.

CONCLUSION: Local control and accountability in relation to generation, reliability and reasonable pricing has a high value that should not be surrendered unless and until there is a clear demonstration that Electric Restructuring benefits all customers. In well over a decade of a relatively few states experimenting with ER, such a demonstration has yet to be made.

Will Competition Produce Better Results?

The Goldwater Institute ("Institute") provides the following response to question no. 2, "Every customer class in every market benefits from competition and always has." Blind faith in competitive markets without an understanding of the electric industry has led to the debacle in California and ongoing difficulties in some other states that have adopted ER. The proposition

that competitive markets always produce good results ignores reality. In the electric industry, high barriers to entry for generators (among them, complex construction and siting processes, highly capital intensive central station power resources and requirements that needs be met regardless of traditional supply/demand assumptions) demonstrate that ER will not provide safe, reliable and adequate power to all consumer classes at reasonable rates. Electricity simply is not an "optional commodity" which practically or legally can be left to market pricing discipline.

What is the Problem that ER Will Fix?

High Electric Utility Prices? No.

Arizona is not a high cost state as demonstrated by cost comparisons of average rates by state. After 13 years of ER, there are no independent studies that demonstrate that ER will lower electricity prices for customers. In fact, considerable evidence suggests residential and small commercial rates consistently increase under an ER regime. Further, as APPA studies for the past 15 years have consistently demonstrated, customers in deregulated states pay, on average, rates that are 3 cents per kWh higher than in regulated states, i.e., currently 11.9 cents per kWh vs. 8.9 cents.

Reliability? No.

Arizona's electric utilities consistently earn good ratings for high standards of customer service and reliability. Reliability suffers under ER due, among other things, to the disincentive to build new generation. Texas has experienced blackouts and low reserve margins since it embraced ER. California forever stands as the most cautionary example of ER's invitation to the potential for market and pricing manipulation leading to dramatic power supply and market failures.

Low Natural Gas Prices Are Not Flowing Through to Large Customers.

Arizona's electric utilities have a diversified plant portfolio which may have a higher average cost than plants that burn natural gas. But, these coal, nuclear and renewable assets serve as a price hedge on natural gas prices that fluctuate drastically based on a variety of factors. The price aftermath of hurricane Katrina is only one in a series of cautionary tales concerning the dangers of relying on sole or limited resource options.

CONCLUSION: Given the demonstrated risks of price volatility, lower reliability and the loss of ACC jurisdiction that are associated with ER, it simply is not worth it. Proponents of ER cannot demonstrate (1) there are benefits to all customers and (2) that reliability will not suffer under an ER regime.

THE ELECTRIC COOPERATIVES' REPLY COMMENTS TO THE PARTIES' RESPONSES TO THE QUESTIONS POSED IN THE COMMISSION'S MAY 23, 2013 LETTER TO STAKEHOLDERS

1) Will retail electric competition reduce rates for all classes of customers — residential, small business, large business and industrial classes?

According to some of the commenters, ER will place downward pressure on rates. For example, the Retail Electric Competition Advocates ("RCA") and the Retail Energy Supply Association ("RESA") cite several articles and reports purporting to prove this point. In the first article titled "Regulation and Relevancy: Assessing the Impact of Electricity Customer Choice," the authors criticize a study on electric pricing prepared by independent researcher, Dr. Ken Rose, which is cited by the Cooperatives in their July 15 comments. One of the authors (John L. Domagalski) of the first article (A1) relied upon by RCA/RESA is currently employed by marketer Constellation. Its second author (Philip R. O'Connor) was formerly employed by New Energy Ventures Midwest – an electricity retailer in Illinois. O'Connor also wrote the second article (A8) prepared for the Compete Coalition which is cited by RCA/RESA in response to this question. The third cited article (A10) is a one-page blog on the Compete Coalition website and the fourth item (A2) is a table prepared by the Compete Coalition. While, given their sources, it is not surprising that each of these articles conclude there are pricing benefits from competition, it is surprising that RCA/RESA believe these articles could be considered by the Commission as independent verification that retail competition somehow will reduce rates for all classes of customers.

To date, the studies conducted by independent researchers – such as Dr. Ken Rose in an article entitled "States Retail Electricity Markets: How Are They Performing So Far" – suggest that customers in ER states have higher rates than in regulated states.

2) In addition to the possibility of reduced rates, identify any and all specific benefits of retail electric competition for each customer class.

Several ER proponents state that just offering a choice to customers is a benefit and that customers value being able to choose their electric supplier. To the contrary, the Cooperatives know that customers – especially residential and small customers – value stable pricing and reliability much more than the ability to choose a competitive supplier. Once factors such as consumer subject matter confusion, significant price fluctuations, limited savings with a significant increase in price risk and associated reliability are considered, residential and small commercial customers are reluctant to vote for choice over stable prices and reliability. Those facts are confirmed by AARP's survey of customers in Connecticut as well as the Maine Public Utilities Commission survey of customers (cited in the AARP's filed comments at page 11).

It's also misleading that energy marketers are hailing the value of customers being able to make choices in states like Texas where all residential customers were switched to competitive suppliers whether they chose to switch or not. Further, it's no shock that several energy marketers filed comments stating that no limits should be placed on the number or type of customers that can be switched. One can readily conclude that it really is energy marketers not customers that gain from "choice."

Energy marketers will choose to serve only the most profitable customers.

Various parties state that ER will result in the following benefits: flexible terms; price signals and transparency; innovation in energy options and services; fixed rate products; term length, seasonal, time of use and various combinations of price certainty; and risk rates and rate programs. The reality is that most, if not all, of the benefits/products listed can be and, in many instances, already are provided by incumbent utilities under the current regulated environment. Finally, if the goal is to increase product options for customers, that can and regularly is done under the current regulatory system without subjecting customers to the numerous risks associated with an ER market place.

3) How can the benefits of competition apply to all customer classes equally or equitably?

They can't for many of the reasons already discussed. RCA/RESA and several other ER proponents state it is necessary for all customers eventually to be forced off POLR or standard utility service to a competitive model in order for all customer classes to "experience the benefits" of ER. This obviously is not customer choice. It is, instead, the recommendation of energy marketers which hope the state and regulator will form their "market" for them.

4) Please identify the risks of retail electric competition to residential ratepayers and to the other customer classes. What entity, if any, would be the provider of last resort?

AARP, in its response, has thoroughly identified and explained the risks to residential and small commercial customers which ER poses. These multiple risks serve as a compelling case for not moving forward with ER.

On the other side, the Institute concludes: "All electricity customers will benefit from competition even if not all choose the very best deal" – a rather subtle way of conceding that there assuredly will be losers in the "choice for choice sake's" game. The Institute also must continue the mantra that electricity markets are inherently competitive despite economic facts to the contrary (high barriers to entry being a prime one). Competitive markets should respond to high prices for generation by building new generation, but they are not in states like Texas, Maryland and New Jersey. Why? Because suppliers have understandably concluded that new supply will only reduce the high prices they are currently receiving; so, why build more and cut the profit stream?

RCA/RESA discuss a Zero-Sum Game scenario where competition will only result in large customers receiving cost savings that will be paid for through higher prices for residential and small commercial customers. RCA/RESA further state that this scenario has no basis in fact because utilities can sell the electricity that was being sold to large customers in the wholesale market. The Cooperatives and RCA/RESA agree that under ER, large customers will take service from competitive suppliers. However, RCA/RESA completely dismiss the

fact that this will have any financial effect on the Cooperatives and their members. Ignoring that fact doesn't make it go away.

For example, several of the Cooperatives serve large retailers such as Safeway Stores, Home Depot and Wal-Mart. Each of these larger customers pay generation costs that range from approximately $200,000 to $500,000 per year. According to RCA&RESA, the loss of these larger customers will have no impact on the Cooperatives or their members.

The truth is the loss of these and other commercial loads will have a very large impact on each cooperative and its members. In addition, because the Cooperatives are customer-owned, there are no third-party shareholders to share losses. After a large retailer leaves, in order to keep its rates from rising for other customers, a cooperative's options are to replace this load, lower costs and/or raise rates. Lowering costs is difficult, because most of a cooperative's costs are fixed and do not vary with the number of kWh sold. In addition, the AEPCO (power supplier) member cooperatives have agreed to pay a fixed charge for the portion of plant AEPCO has constructed and operates to serve their members. This fixed charge from AEPCO does not change with the number of kWhs that a cooperative's members use, because it provides the necessary revenue to pay the fixed costs and debt associated with AEPCO's generation assets which don't change with the amount of power consumed. So, in each cooperative's case, it will need to replace this large retail load ($200,000 to $500,000 in generation costs per year) or remaining customers will have to pay higher rates to cover a larger portion of the AEPCO fixed charge. Even if AEPCO can sell the energy formerly sold to a departing large retailer into the market – as RCA&RESA

suggest as the solution – it will do so at a significantly lower rate than it was collecting for the fixed and variable generation costs from its members.

The likelihood of the cooperatives replacing a load such as a Wal-Mart or the few other large loads on rural systems is slim to none. Even if a cooperative was lucky enough to have another Wal-Mart open in its service area, under ER, Wal-Marts and other large customers likely will negotiate statewide contracts with competitive suppliers covering all their urban and rural outlets, so the Cooperatives will not be serving any new large customers. Finally, a cooperative needs to add approximately 333 new residential customers to recover a generation cost of $200,000 and to add 833 new residential customers to recover $500,000 in generation costs. Obviously, population surges like that don't happen in our rural service territories.

For the Cooperatives, Wal-Marts or other big box stores, grocery stores, hotels and casinos are large customers. While these large customers only comprise 12 percent of the number of customers, kWh sales to these large customers account for three times that number or 37 percent of the Cooperatives' revenues on a statewide basis. The negative financial effects on Cooperatives and their remaining members from losing large customers to alternative energy suppliers cannot be denied or explained away by RCA&RESA and the other parties that favor ER.

RCA/RESA state the entire point of competition is to encourage greater operating efficiencies, such as utilities' purchasing power when the market cost is lower than their

own generation. Obviously, they are not aware that utilities, including AEPCO, already dispatch their generation only when it is cheaper to run than to purchase from the market. The problem is this routine least cost practice does not provide any recovery of AEPCO's fixed costs. Those "stranded" costs will have to be covered by higher rates to remaining residential and small commercial customers.

The Cooperatives do agree with RCA/RESA that full recovery of the utilities' fixed (stranded) generation, transmission and distribution costs should be dealt with separately.

RCA/RESA also state that the following risks are presently being borne by utility customers: (1) distorted electricity prices, (2) tariff rigidity, (3) lack of customization to fit individual needs and (4) risks borne by consumers receiving power from utilities which own generation.

The point concerning distorted electricity prices makes no sense. The Commission sets prices based on costs so there is a solid basis for the price which also provides rate stability for customers. In a competitive system, market prices fluctuate and are not cost-based. Concerning tariff rigidity and lack of customization, both can be and are regularly addressed by utilities and the Commission in the currently regulated environment. Other parties also frequently request new or different rate designs.

There are, of course, risks of owning any generation assets – just as there are risks of owning few or none. Equally true is the fact that there are considerable benefits associated with ownership. The bottom line is a balanced portfolio limits risk and also provides the significant benefit of minimizing the fuel price risk associated with owning only one type of generation.

Finally, RCA/RESA state – we're not sure if in jest or not – that because the Commission has considered the issues associated with ER 13 years ago, all that is necessary is to update the work done previously. Obviously, a transition to ER will require an enormous amount of time, expense, research and coordination. Please refer to the APS July 15 comments' response to Question No. 6 for a more detailed discussion of issues that must be addressed before the Commission can proceed with implementing ER.

5) How can the Commission guarantee that there would be no market structure abuses and/or market manipulation in the transition to and implementation of retail electric competition?

It can't. RCA/RESA answer this question by stating that the Commission through the CC&N process and AZISA protocols can prevent market structure abuses and/or market manipulation by competitive retail suppliers. Obviously, those procedures elsewhere – from the northeast United States to California – have failed to prevent repeated instances of abuse and manipulation. There is no reason to believe Arizona will fare any better. We also note that there is no Commission Staff currently available to monitor compliance or enforce safeguards, especially given the 40 or more competitive suppliers who may want to provide service to Arizonans. Further, Regulatory/ISO efforts, rules, laws and CC&N processes in other states have not prevented market abuses and manipulation.

It is difficult to believe any of the ER proponents' responses to this question, given Constellation Energy Commodities Group Inc.'s ("Constellation") $245 million settlement in 2012 with regulators to close charges of power market manipulation. For additional discussion concerning recent market manipulation issues, refer to

TEP's response to question no. 5 in its July 15 comments.

6) What, if any, features, entities or mechanisms must be in place in order for there to be an effective and efficient market structure for retail electric competition? How long would it take to implement these features, entities, or mechanisms?

Please refer to APS' July 15 response to Question No. 6 for a thorough explanation of the issues and a timeline that must be addressed before the Commission can proceed with ER.

7) Will retail electric competition require the divestiture of generation assets by regulated electric utilities? How would FERC regulation of these facilities be affected?

Again, we note that forced divestiture is not possible under *Phelps Dodge*. The Cooperatives' primary concerns with divesture have been summarized in the "Accountability to Our Members" section of these comments.

8) What are the costs of the transition to retail electric competition, how should those costs be quantified, and who should bear them?

ER proponents have identified some of the costs of transition to ER. For a more complete costs breakdown, refer to the APS and SRP July 15 responses. Worth noting is the difference in the actual annual costs to operate RTOs and ISOs – most of which are in the hundreds of millions of dollars as detailed in SRP's response – versus the estimated cost of only $16 million given in the AZISA response to this question.

9) Will retail electric competition impact reliability? Why or why not?

The Compete Coalition, RCA/RESA and other ER proponents state there is no evidence that retail electricity markets adversely impact or compromise reliability. ER proponents are quick to point to NERC, WECC and FERC as the reliability managers of the electric system. What is not mentioned is the fact that in states that have adopted ER, the role state commissions have in the planning, siting, building and retirement of generation (all essential reliability elements) is greatly diminished.

While RCA/RESA acknowledge the importance of generation resource adequacy, they incorrectly imply that states that have implemented ER have adequate growth in generation capacity. This is simply not the case in several ER states such as Maryland, New Jersey and Texas.

For example, on January 7, 2013, the North American Reliability Corporation ("NERC") sent a letter to the Electric Reliability Council of Texas ("ERCOT") stating "...one area of concern requiring immediate attention is the projected Planning Reserve Margin levels in the ERCOT assessment area. Capacity resources in ERCOT have drifted to a level below the Planning Reserve Margin target and are projected to further diminish through the ten-year period covered in the assessment. It is clear to me... ERCOT will need more resources as early as summer 2013 in order to maintain a sufficient reserve margin." *See* attached letter from NERC to ERCOT.

For a further description of ER's effects on reliability, *see* the APS and SRP July 15 responses to question no. 9.

10) What are the issues relating to balancing area authorities, transmission planning, and control areas which must be addressed as part of a transition to retail electric competition?

An ISO or RTO will need to be formed or joined to address balancing authorities, transmission planning and control areas and could cost hundreds of millions of dollars. As noted previously, the *Phelps Dodge* case held that the Commission could not constitutionally require participation in such an organization. That leaves the fate of this issue, at best, undecided.

11) Among the states that have transitioned to retail electric competition, which model best promotes the public interest for Arizonans? Which model should be avoided?

The Compete Coalition responded to this question that arbitrary limits should not be placed on which entities, resources or customers can participate in competition and recommended avoiding the approach used in Michigan and California for such reasons. RCA/RESA discussed key characteristics of successful models, but did not offer any state model which would promote Arizona's public interest. The reluctance and/or inability of ER proponents to identify or endorse a single state which has done this "right" speaks volumes about the lack of benefits for customers and failures in ER markets.

12) How have retail rates been affected in states that have implemented retail electric competition?

See the Cooperatives' response to question no. 1. For a discussion of effects of ER on retail rates, the Cooperatives also refer the Commission to AARP and SRP's July 15 responses to question no. 1.

13) Is retail electric competition viable in Arizona in light of the Court of Appeals' decision in *Phelps Dodge Corp. v. Ariz. Elec. Power Coop.*, 207 Ariz. 95, 83 P.3d 573 (App. 2004)? Are there other legal impediments to the transition to and/or implementation of retail electric competition?

See the legal Rebuttal Comments which are attached as Exhibit A.

14) Is retail electric competition compatible with the Commission's Renewable Energy Standard that requires Arizona's utilities serve at least 15% of their retail loads with renewable energy by 2025? (See A.A.C. R14-2-1801 et seq.)

Somewhat inexplicably, RCA/RESA and the Compete Coalition as well as all of the renewable energy proponents have responded that the REST Standard is compatible with ER. Obviously, it seems illogical and wholly inconsistent that – if the Commission moves forward to implement ER and, accordingly, will be relying on the market to set a generation mix and prices – it would, at the same time, mandate a certain percentage of the power provided by all providers be renewable. Frankly, it is unclear how the Commission could mandate anything to do with generation once it

implements ER. Even if the Commission were to mandate that all energy marketers must meet the REST Standard, there is no way for the Commission to monitor or enforce this requirement on independent third-party generators. The ACC would need to require each energy marketer (over 40, for example, in Texas) to file a REST plan for ACC approval and REST compliance reports.

15) Is retail electric competition compatible with the Commission's Energy Efficiency Standard that requires Arizona's electric utilities to achieve a 22% reduction in retail energy sales by consumption by 2020? (See A.A.C. R14-2-2401, et seq.)

RCA/RESA, Compete Coalition and AECC have mixed responses on whether the Energy Efficiency ("EE") Standard is compatible with ER. Again, it seems, at best, illogical that the Commission – if it moves forward with the implementation of ER so as to rely on the market for power – would at the same time mandate that energy marketers meet an EE Standard.

16) How should the Commission address net metering rates in a competitive market?

The Cooperatives have no reply comments to the other parties' responses to this question at this time.

17) What impact will retail electric competition have on resource planning?

Most of the ER proponents responded correctly that Integrated Resource Planning ("IRP") is obviously not compatible with ER. In a restructured market place, the market will

determine the generation mix used and to be constructed, not ACC policy. In addition, IRP information would, of necessity, be highly confidential in a restructured, competitive market place.

18) How will retail electric competition affect public power utilities, cooperatives and federal controlled transmission systems?

Of the 60 parties that provided responses on July 15, few directly advocate for ER in the Cooperatives' service areas. The Cooperatives also refer the Commission to the Cooperatives' response to question no. 4 which discusses reasons why the Cooperatives should not be required to implement ER in their service areas such as the disproportionately (high) share of revenues (37%) from the Cooperatives' large customers (12%) with no ability to replace the loads lost to energy marketers.

As stated in the Cooperatives' responses to the questions filed on July 15, the Cooperatives strongly recommend the Commission not implement ER in Arizona. But, if it does proceed, the Cooperatives request an exemption for their service territories. However, it should be understood that an exemption will not insulate the Cooperatives and their members from an interconnected system that will be affected by the higher prices of market generation, the burden of ISO/RTO costs, lower reliability, market manipulation and the other negatives associated with ER.

EXHIBIT A

REBUTTAL COMMENTS IN RELATION TO QUESTION 13 OF THE COMMISSION'S MAY 23, 2013 NOTICE OF INQUIRY INTO RETAIL ELECTRIC COMPETITION IN ARIZONA
Regarding *Phelps Dodge* and Other Legal Impediments

I. INTRODUCTION.

These rebuttal comments respond to certain legal arguments raised by those in favor of implementing retail electric competition in Arizona (the "EC Supporters"). In light of the large number of comments filed in Docket No. 13-0135 (more than 50 filings were submitted), it is impracticable to attempt to respond to all of the EC Supporters' assertions. This is especially true given the fact that we are responding to a purely theoretical construct with no specific proposed rules to assess. Our failure to respond to any issue raised by EC supporters is not to be construed as agreement with or acquiescence to it.

With these considerations in mind, these rebuttal comments focus primarily on recurring themes in several of the EC Supporters' filings, including: arguments relating to the 1998 retail electric competition statutes; whether and to what extent the 1999 Commission Rules are still viable or revivable; and misinterpretations of the holdings of and the regulatory requirements set forth in *Phelps Dodge Corp. v. Arizona Elect. Power Coop.*, 207 Ariz. 95, 83 P.3d 573 (App. 2004).

II. DISCUSSION.

A. The Commission's 1999 Retail Electric Competition Rules Are Not Valid or Revivable.

As Utilities Division Director Steve Olea correctly recognizes: following *Phelps Dodge*, the Commission's 1999 Retail Electric Competition Rules (the "Rules") are "Swiss cheese," at best. Several EC Supporters ignore this fact – incorrectly suggesting that the Rules are still largely enforceable. In fact, *Phelps Dodge* held many of the Rules procedurally and substantively invalid in whole or in part. As it stands, there is simply no practical way to use or enforce the Rules that remain.

Further, *Phelps Dodge* expressly left open the possibility that any of the Rules which remain hobbled, but standing somewhat, could be deemed unconstitutional *as applied*. The Cooperatives in *Phelps Dodge* challenged the *facial* validity of certain Rules, not the validity of those Rules *as applied*. 207 Ariz. at 106-110, ¶¶ 29, 45-52, 83 P.3d at 584-88. The Court distinguished between the two, stating: "[t]he Rules are unconstitutional on their face if they cannot be applied under any circumstances without violating Article 15, Sections 3 and 14 . . . Otherwise, their constitutionality can only be attacked as applied in particular circumstances." *Id.* at 109-110, ¶ 46, 83 P.3d at 587-88.

This distinction is significant because several of the Rules that the Court did not invalidate in *Phelps Dodge* are nevertheless quite susceptible to challenge as applied. For example, the Cooperatives challenged certain Rules that would "allow ESPs to charge different rates to similarly situated customers," in violation of the antidiscrimination provisions in Article 15, Section 12 and A.R.S. § 40-334. The Court simply held that this issue was not yet ripe for review. *Phelps Dodge*, 207 Ariz. at 119, ¶ 99, 83 P.3d at 597. The Court reasoned: "[u]ntil an ESP charges a rate that allegedly violates these provisions, allowing the court to apply legal principles to a concrete set of facts, the issue is not ready for review." *Id.* This holding does not change the fact that those Rules are written in a way that makes it possible for ESPs to charge discriminatory rates. Thus, it is only a matter of time before the Rules will be challenged as applied.

As APS notes at pages 27-28 of its July 15 comments, a closely related legal impediment is the price transparency requirements of A.R.S. § 40-367 which requires prices be held open for public inspection. Thus, the price secrecy of individual transactions which competitive providers no doubt will seek under broad ranging, flex tariffs is statutorily prohibited.

Other EC Supporters try to downplay the impact of *Phelps Dodge* by arguing that several of the Rules declared invalid can be immediately revived by simply submitting them to the Attorney General for review and approval. This argument is misguided and naive. While it is true that several of the Rules were held invalid because they were not sent to the Attorney General, much more than a decade has passed since those Rules were passed, and nearly a decade has passed since *Phelps Dodge* declared them invalid. Yet, they *still* have not been submitted for Attorney General review. As legal and practical matters, it is simply too late to hit the rewind button. Further, even trying would create a host of related problems.

As APS correctly recognizes in its comments: "[s]ome of these rules have become moot or at least dated by the passage of so much time." APS Comments at p. 26. And "[t]he Economic, Small Business and Consumer Impact Statements that accompanied the original Electric Competition Rules, and which are required by the APA, are likewise stale." *Id.* "Bottom line, the rules for any contemplated deregulation are effectively nonexistent, and need to be formulated, debated, and, if passed, submitted to the AG in accordance with the law." *Id.*

B. Retail Electric Competition Is Inherently Antithetical to the Requirements of *Phelps Dodge.*

EC Supporters argue that the competitive market can operate within the parameters of *Phelps Dodge*. However, in making this argument, their comments consistently contradict or altogether ignore two key *Phelps Dodge* holdings:

(1) The Commission is required to *use* fair value in a meaningful way in setting just and reasonable rates; it is not enough to find fair value and then disregard it. *Phelps Dodge*, 207 Ariz. at 128, ¶ 152, 83 P.3d at 606 ("Even in a competitive market, Article 15, Section 14, of the Arizona Constitution requires the Commission to determine the fair value of Arizona property owned by a public service corporation *and consider that determination in establishing just and reasonable rates.*") (emphasis added); *see also US*

West Communications, Inc. v. Arizona Corp. Com'n, 201 Ariz. 242, 246, ¶ 20, 34 P.3d 351, 355 (2001) ("We do not hold that a fair value determination should play *no* role in the establishment of rates, or that it can simply be ignored. On the contrary, section 14 mandates that the corporation commission determine fair value "to aid it in the proper discharge of its duties.") (emphasis added). To the extent that EC Supporters suggest that the Commission can find fair value and then simply disregard it, they are clearly mistaken. *See id.*

(2) Further, while it is permissible for the Commission to set a range of rates, the range must be sufficiently narrow so as not to undermine or ignore the Commission's obligation to set just and reasonable rates. *Phelps Dodge*, 207 Ariz. at 107, ¶ 33, 83 P.3d at 585 ("We reject the Commission's contention that its approval of a broad range of rates within which the competitive marketplace can operate satisfies the Commission's obligation to set just and reasonable rates.") (emphasis added). In so holding, *Phelps Dodge* rejected a range of rates that would have given PG&E the ability to negotiate within its proposed range of roughly 500 to 800 times the wholesale cost of electricity. Across the board, the EC Supporters' comments recognize that *Phelps Dodge* permits ranges of rates, but completely ignore the requirement that those ranges to be sufficiently narrow to conform to the case's requirements. Undoubtedly, this is because most, if not all, of the pending retail electric competitors' CC&N applications propose ranges of rates either without ascertainable caps or ranges that are capped at amounts dozens of times greater than wholesale electricity prices (in other words, they are effectively unrestricted prices). The EC Supporters' efforts to ignore the *Phelps Dodge* holding will not make it go away – unlimited ranges of rates within which the competitive market can operate are not permissible. *Id.* Once again, this begs the question: "Is there a permissible range of rates that would even appeal to a competitive electric service provider?" Based on the CC&N applications, we submit that there is not.

C. The 1998 Retail Electric Competition Statutes Are Also Susceptible to Challenge.

At least one EC Supporter argues that the Arizona Legislature has fully authorized retail electric competition through statutes enacted in 1998 (via HB 2663) (the "Statutes"). While it is true that these Statutes have not been declared invalid, they are very susceptible to challenge under *Phelps Dodge*.

When the Arizona Legislature enacted the Statutes, it published an express declaration of legislative intent that recognized several "specific policies" that the Legislature sought to outline in the Statutes. Laws 1998, Ch. 209, § 35, Legislative Intent. The first policy states: "retail electricity prices set by a competitive market meet the *constitutional* test of being just and reasonable." In *Phelps Dodge*, the Arizona Court of Appeals was asked to determine whether R14-2-1611(A) – declaring that "market determined rates . . . shall be deemed just and reasonable" – was invalid. The Court held this Rule *facially unconstitutional* because it improperly delegated the Commission's constitutionally mandated ratemaking responsibilities to the marketplace. *Phelps Dodge*, 207 Ariz. at 108, ¶ 39, 83 P.3d at 586. It follows that because the primary policy upon which the Legislature relied in drafting and enacting the Statutes was

subsequently declared unconstitutional in *Phelps Dodge*, the Statutes themselves remain quite susceptible to challenge.

Finally, at least one EC Supporter argues that *Miller v. Arizona Corp. Com'n*, 227 Ariz. 21, 251 P.3d 400 (Ct. App. 2011), "essentially overruled" *Phelps Dodge*. This argument is a red herring. In *Miller*, the plaintiffs challenged the Commission's renewable energy rules. The Court held that there was "a sufficient nexus between the REST rules and ratemaking," and that "[p]rophylactic measures designed to prevent adverse effects on ratepayers due to a failure to diversify electrical energy sources fall within the Commission's power 'to lock the barn door before the horse escapes.'" 227 Ariz. at 29, ¶ 31, 251 P.3d at 408.

This case obviously did not overrule any *Phelps Dodge* holding. Rather, it was a challenge to a separate, distinct and what the Court ruled was a proper exercise of the Commission's ratemaking power. *Phelps Dodge*, on the other hand, held that the Commission's attempt effectively to ignore several of its constitutional and statutory obligations did not pass muster.

III. CONCLUSION.

The EC Supporters' comments do not overcome the many legal impediments to retail electric competition in Arizona under *Phelps Dodge* and other settled law. Simply stated, a market where the "invisible hand of competition" sets electric rates is constitutionally barred in the Grand Canyon State.

NERC
NORTH AMERICAN ELECTRIC RELIABILITY CORPORATION

Gerry W. Cauley
President and CEO

January 7, 2013

Mr. Trip Doggett
President and Chief Executive Officer
Electric Reliability Council of Texas
7620 Metro Center Drive
Austin, TX 78744

Dear Mr. Doggett,

On November 29, 2012, North American Electric Reliability Corporation (NERC) released the *2012 Long-Term Reliability Assessment*,[1] an annual report prepared by the electric reliability organization on future reliability.[2] The report assesses the adequacy of the bulk power system (BPS) in the United States and Canada over a ten-year period. The report projects electricity supply and demand, evaluates transmission system adequacy, and discusses key issues and trends that could affect reliability. The 2012 report highlights several key findings and recommendations.

At its November 26, 2012 meeting, the NERC Board of Trustees (Board) discussed its concerns for the situation in Electric Reliability Council of Texas (ERCOT). While it was noted that NERC cannot order the construction of new generation or transmission, NERC is accountable for assessing the current and future reliability of the BPS and informing decision-makers. Therefore, the Board requested that NERC take follow-on actions with the organizations that *are* responsible for resource adequacy to ensure the parties are taking timely action.

As identified in the assessment, one area of concern requiring immediate attention is the projected Planning Reserve Margin levels in the ERCOT assessment area. Capacity resources in ERCOT have drifted to a level below the Planning Reserve Margin target and are projected to further diminish through the ten-year period covered in the assessment. It is clear to me that these levels imply higher reliability risks especially the potential for firm load shed, and ERCOT will need more resources as early as summer 2013 in order to maintain a sufficient reserve margin.

[1] 2012 Long-Term Reliability Assessment: http://www.nerc.com/files/2012_LTRA_FINAL.pdf

[2] Section 39.11(b) of the U.S. FERC's regulations provide that: "The Electric Reliability Organization shall conduct assessments of the adequacy of the Bulk Power System in North America and report its findings to the Commission, the Secretary of Energy, each Regional Entity, and each Regional Advisory Body annually or more frequently if so ordered by the Commission."

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These concerns are not new, as NERC has raised this issue in prior assessments.[3] It is my understanding that the ongoing resource adequacy challenges in ERCOT are being addressed through your work with the Public Utility Commission of Texas (PUCT). While some enhancements have already been made, such as increasing the scarcity pricing cap, solutions have not yet sufficiently materialized to address NERC's reserve margin concern. Further, it is still unclear to us how ERCOT intends to mitigate issues that may arise on the current trajectory and when new resources may be available to meet growing demand.

As recommended in the report, ERCOT should consider additional potential solutions to address resource adequacy and provide a plan outlining the measures it is taking to increase reserve margins and ensure reliability. It is essential to send the right reliability signals to prospective generation, and also ensure that the PUCT has sufficient information to fully understand the increasing risks; therefore, ERCOT should continue to provide information, data, and transparent reliability assessments to the PUCT (as well as to Texas Reliability Entity, Inc.) for continued development of solutions concerning the declining reserve margins.

It is essential that NERC understand how ERCOT plans to remedy NERC's concerns. Therefore, I am requesting that you report to NERC, no later than April 30, 2013, ERCOT's plan to address the declining reserve margin and projected capacity shortfall, including a discussion of the risks to reliability if new resources are not constructed or acquired in the short term. The report should provide a summary of actions planned (for both the planning and operations horizons), including the planned timetable by which NERC can track progress with you. To the extent that these actions include corresponding policy decisions determined at the PUCT level, we would appreciate a summary of these, as well. We invite you to present ERCOT's outlook and plans to address resource adequacy to the NERC Board of Trustees at its May 9, 2013 meeting. Additionally, updated projections will be expected for inclusion in the *2013 NERC Summer Reliability Assessment*.

Once again, thank you for your responsiveness at this critical time in addressing the issues outlined in the assessment and in this letter. It is my intent that these follow-on activities will provide the additional rigor needed to address diminishing reserve margins and emphasize that this is a significant reliability issue.

Sincerely,

Gerry Cauley
President and CEO

cc: Mr. Lane Lanford, President and CEO, Texas Reliability Entity, Inc.
The Honorable Donna L. Nelson, Chair, Public Utility Commission of Texas
The Honorable Kenneth W. Anderson, Jr., Commissioner, Public Utility Commission of Texas
The Honorable Rolando Pablos, Commissioner, Public Utility Commission of Texas

[3] 2011 Long-Term Reliability Assessment: http://www.nerc.com/files/2011%20LTRA_Final.pdf

2010 Long-Term Reliability Assessment: http://www.nerc.com/files/2010_LTRA_v2-.pdf